

MAJOR FRAUD AMENDMENTS OF 1989

MARCH 13, 1989.—Ordered to be printedFiled under authority of the order of the Senate of March 9 (legislative day,
January 3), 1989

Mr. BIDEN, from the Committee on the Judiciary,
submitted the following

REPORT

[To accompany S. 248]

The Committee on the Judiciary, to which was referred the bill (S. 248) to amend Title 18, United States Code, to provide for discretionary payments to individual who furnish information leading to convictions under the Major Fraud Act of 1988 (Public Law 100-700), having considered the same, reports favorably thereon and recommends that the bill, as amended, do pass.

I. PURPOSE

The purpose of S. 248, the Major Fraud Amendments of 1989, is to encourage persons to provide information on fraudulent contractor practices for federal prosecutors so that fraudulent schemes may be thwarted early, and successful prosecutions may be insured.

II. LEGISLATIVE HISTORY

S. 248, introduced on January 25, 1989, is an amendment to the Major Fraud Act of 1988 (Public Law 100-700). The Major Fraud Act imposes severe criminal penalties on government contractors convicted of defrauding the government. This legislation was an important step in curbing the losses taxpayers suffer as a result of major fraud in connection with million-dollar contractors. In addition to curbing financial losses, Congress intended that the Major

Fraud Act curb procurement fraud that can cause the loss of life of American soldiers and thereby threaten national security.

The substantive language of S. 248 was included in the H.R. 3911 as it was passed by the House May 10, 1988, and as it was reported from the Senate Judiciary Committee during the 100th Congress, September 7, 1988. During Senate floor consideration, concerns were raised regarding the propriety of a reward provision. A floor amendment striking the reward provision was agreed to in order to expedite passage of the bill.

S. 248 also contains a technical amendment striking Section 3 of the Major Fraud Act of 1988 (Public Law 100-700). The effective date of this repeal is November 19, 1988. Section 3 (on allowable costs) was included in H.R. 3911, as reported by the Senate Judiciary Committee. (See Cong. Rec. October 18, 1988, S16697.) During Senate consideration of H.R. 3911, Senator Grassley offered, and the Senate agreed to an amendment which was a complete substitute for Section 3. (See Cong. Rec. October 18, 1988, S16701-16702, S16704.) Inadvertently, the substitute language failed to delete Section 3 of H.R. 3911. On October 21, 1988, the Senate passed a concurrent resolution to correct this mistake (October 21, 1988, S17149), but the House did not act. The committee intends to make it clear that Section 3 was never intended to take effect, and that the subsequent amendment on allowable costs, now Section 8 of Public Law 100-700, took effect and applies to contracts entered into after November 19, 1988, the day Public Law 100-700 became law.

S. 248 was referred to the Committee on the Judiciary on January 25. At the committee markup on February 23, 1989, the committee, by voice vote, reported S. 248 to the full Senate.

III. DISCUSSION

Section 2 of the Major Fraud amendments of 1988 would add a new subsection (g) to Title 18 U.S.C. 1031. New subsection (g) would authorize the Attorney General to seek payments to "whistleblowers" who furnish information leading to convictions for major contractor fraud against the United States. The Attorney General has complete discretion to make such application for a reward payment, and the court may order the payment. The payments would be made from criminal fines levied upon the conviction of a contractor under the Major Fraud Act of 1988. The amount of the payment shall not exceed the lesser of \$250,000 or 10 percent of the criminal fine.

Under certain circumstances, an individual is not eligible for a payment. S. 248 disqualifies officers or employees of government agencies who furnish information or render service in the performance of officials duties. S. 248 also disqualifies individuals who unjustifiably fail to furnish information to the individual employer before furnishing it to law enforcement agencies. S. 248 also disqualifies individuals who furnish information which is publicly disclosed unless the individual is the original source of the information. Finally, S. 248 disqualifies any individual who participated in a violation of the Major Fraud Act.

The committee believes that, in special circumstances, rewards under this act may serve the goal of eliminating procurement fraud. At the same time, the committee recognizes that prosecutors are in the best position to determine the utility or rewards under this Act. The committee also recognizes that awards to individuals under some circumstances may make a conviction more difficult to obtain—for example, by rendering the individuals, if used as prosecution witnesses, vulnerable to impeachment on cross-examination. Thus, S. 248 vests sole discretion in the Attorney General to request a reward payment, and the court may order that such a payment be made pursuant to the Attorney General's request.

IV. TEXT OF S. 248

[S. 248, 101st Cong., 1st Sess.]

A BILL To amend title 18 of the United States Code to provide increased penalties for certain major frauds against the United States

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Major Fraud Act Amendments of 1989".

SEC. 2. REWARD FOR WHISTLEBLOWERS.

(a) AMENDMENT TO TITLE 18.—Section 1031 of title 18, United States Code, is amended by inserting after subsection (f) the following new subsection:

"(g)(1) Upon application by the Attorney General, the court may order a payment from a criminal fine under this section to an individual who furnished information leading to the conviction under this section. The amount of such payment shall not exceed the lesser of \$250,000 or 10 percent of the criminal fine imposed under this section.

"(2) An individual is not eligible for such a payment if—

"(A) that individual is an officer or employee of a government who furnishes information or renders service in the performance of official duties;

"(B) that individual failed to furnish the information to the individual's employer prior to furnishing it to law enforcement authorities, unless the court determines the individual has justifiable reasons for that failure;

"(C) the furnished information is based upon public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or GAO report, hearing, audit or investigation, or from the news media unless the person is the original source of the information. For the purposes of this subsection, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the Government; or

"(D) that individual participated in the violation of this section with respect to which such payment would be made."

(b) **APPLICABILITY.**—The amendment made by this section shall apply to contracts entered into on or after the date of the enactment of this Act.

SEC. 3. TECHNICAL AMENDMENT.

(a) **REPEAL.**—Section 3 of the Major Fraud Act of 1988 (Public Law 100-700) and the amendment made by such section are repealed.

(b) **EFFECTIVE DATE.**—The repeal made by this section shall be deemed to be effective on the date of enactment of Public Law 100-700.

V. SECTION-BY-SECTION ANALYSIS

Section 1 of the Major Fraud Amendments provides that S. 248 may be cited as the "Major Fraud Amendments of 1989".

Section 2 of the Major Fraud Amendment of 1989 adds a new subsection (g) to Section 1031 of Title 18, United States Code. Section 1031(g) would establish a new reward system under which certain individuals who provide information to the government which leads to a conviction may receive a payment of up to \$250,000.

Subsection (g)(2) sets out a number of instances where an award is precluded including cases where:

(1) the individual is an officer or employee of the government who furnishes information or renders services in the performance of official duties;

(2) the individual failed to furnish the information to his or her employer prior to furnishing it to law enforcement authorities, unless the court determines the individual had justifiable reasons for the failure;

(3) the information is based upon public disclosure of facts already revealed in a hearing or investigation "unless the person is the original source of the information"; and

(4) the individual participated in the violation of this section with respect to which such payment would be made. Subsection (g)(2)(c) further specifies that an "original source" of information is someone who has direct and independent knowledge of the information and has voluntarily provided the information to the government.

Section 3 is a technical amendment deleting Section 3 of the Major Fraud Act of 1988 (Public Law 100-700). The effective date of this repeal is November 19, 1988. Section 3 (on allowable costs) was included in H.R. 3911, as reported by the Senate Judiciary Committee. (See Cong. Rec. October 18, 1988, S16697.)

VI. COST ESTIMATE

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and Section 403 of the Congressional Budget Act of 1974, the committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, March 6, 1989.

Hon. JOSEPH R. BIDEN, Jr.,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 248, the Major Fraud Act Amendments of 1989, as ordered reported by the Senate Committee on the Judiciary, February 23, 1989. CBO estimates that enactment of this bill would have no significant impact on the federal budget and would result in no costs for state or local governments.

S. 248 would establish a system of rewards for individuals who furnish information leading to convictions under the Major Fraud Act of 1988, which concerns procurement fraud. These rewards would be paid from criminal fines. While these payments would entail some federal costs, such a system could also result in savings if it would encourage individuals to come forward with information about procurement fraud. CBO has no basis for estimating the number or amount of rewards that would be paid under this provision, but the amounts involved are not likely to be substantial.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Marjorie Miller, who can be reached at 226-2860.

Sincerely,

ROBERT D. REISCHAUER,
Director.

VII. REGULATORY IMPACT STATEMENT

Pursuant to paragraph 11(b), rule XXVI of the Standing Rules of the Senate, the committee, after due consideration, concludes that the act will not have a direct regulatory impact.

VIII. AGENCY VIEWS

The views of the Department of Justice of S. 248 are reproduced below.

U.S. DEPARTMENT OF JUSTICE,
OFFICE OF LEGISLATIVE AFFAIRS,
Washington, DC, March 8, 1989.

Senator JOSEPH BIDEN,
Chairman, Senate Judiciary Committee,
Washington, DC.

DEAR MR. CHAIRMAN: This responds to your request for the views of the Department of Justice on S. 248, a bill which would add a reward for information provision to the Major Fraud Act of 1988 ("the Act") and delete an erroneously included provision relating to attorneys fees.

Although we recognize that it is intended that such a reward provision be a mechanism for assisting the Administration in helping to root out procurement fraud against the Government, we must continue to register our strong objection to the provision, as

we did when it was first raised during consideration and passage of the Act in the last Congress.

As you accurately observed during the Committee markup of the bill, it is "unseemly" for the Government, absent the most compelling circumstances, to hold out the offer of financial reward to individuals who provide information in a criminal investigation. We firmly believe that it should be a citizen's moral and ethical foundations which motivates him or her to provide information to law enforcement authorities. The comparison with the practice of various Inspectors General giving such rewards to informants is inexact as those cases are not necessarily criminal in nature and thus do not have the litigation nexus of the S. 248 provision, which conditions the payment of the reward on conviction and the assessment of a fine.

We have no doubt that such a reward provision will seriously impede future prosecution in the procurement fraud area. Persons who may qualify for rewards under this provision will, in all likelihood, be the primary witnesses for the Government. As we have explained to your staff, the ability to prove these cases in court turns, in almost all cases, not on the paper trail created by the defendants, but upon the testimony of such witnesses. If this bill becomes law, the key Government witnesses in major procurement cases will be subject to extensive, and I'm afraid persuasive, cross-examination regarding their pecuniary motives for coming forward, cooperating and testifying.

It has been suggested that Government informants are subject to the same sort of impeachment. We note, however, that we generally reserve using informants for special cases, typically involving violence or the potential for the commission of violence. Moreover, an informant's payment, unlike the reward contemplated by the bill, is not contingent upon a conviction. In cases involving paid informants, the Government usually makes the affirmative decision to use that investigative tool, having carefully weighed the possible costs and benefits, and plans the investigation and prosecution with regard for the inherent credibility problems.

If S. 248 is passed, the *potential* alone for such huge payments, up to \$250,000 in each case, will create an unnecessary avenue for discrediting the initial motivations of our witnesses, with no concomitant benefit to the prosecution. As I indicated above, you can no doubt imagine the uneasiness of the jurors with a witness who stands to be rewarded *only* if the defendant is convicted and a fine is assessed. Not only does this put unwanted doubts into the minds of the jury, it will require the prosecution to expend its already limited resources to ensure the credibility of its witnesses is preserved.

The statement that these witnesses take great personal risk to their careers and future livelihood goes without argument. Suggesting, however, that this reward provision will shield them from repercussions for their actions is, we believe, mistaken, and fails to take into account that the Act already provides significant monetary and other civil relief for persons so aggrieved (see, Section 1031[h]).

The Office of Management and Budget has advised this Department that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

THOMAS M. BOYD,
Assistant Attorney General.

X. CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows: existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italic; existing law in which no change is proposed is shown in roman.

UNITED STATES CODE

* * * * *

TITLE 18—CRIMES AND CRIMINAL PROCEDURE

* * * * *

1031. Major fraud against the United States.

* * * * *

(g)(1) Upon application by the Attorney General, the court may order a payment from a criminal fine under this section to an individual who furnished information leading to the conviction under this section. The amount of such payment shall not exceed the lesser of \$250,000 or 10 percent of the criminal fine imposed under this section.

(2) An individual is not eligible for such a payment if—

(A) that individual is an officer or employee of a government who furnishes information or renders service in the performance of official duties;

(B) that individual failed to furnish the information to the individual's employer prior to furnishing it to law enforcement authorities, unless the court determines the individual has justifiable reasons for that failure;

(C) the furnished information is based upon public disclosure of allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or GAO report, hearing, audit or investigation, or from the news media unless the person is the original source of the information. For the purposes of this subsection, "original source" means an individual who has direct and independent knowledge of the information on which the allegations are based and has voluntarily provided the information to the government; or

(D) that individual participated in the violation of this section with respect to which such payment would be made.

(h) Any individual who—

(1) is discharged, demoted, suspended, threatened, harassed, or in any other manner discriminated against in the terms and conditions of employment by an employer because of lawful acts done by the employee on behalf of the employee or others in furtherance of a prosecution under this section (including investigation for, initiation of, testimony for, or assistance in such prosecution), and

(2) was not a participant in the unlawful activity that is the subject of said prosecution, may, in a civil action, obtain all relief necessary to make such individual whole. Such relief shall include reinstatement with the same seniority status such individual would have had but for the discrimination, 2 times the amount of back pay, interest on the back pay, and compensation for any special damages sustained as a result of the discrimination, including litigation costs and reasonable attorney's fees.

THE INTELLECTUAL PROPERTY ANTITRUST PROTECTION
ACT OF 1989

MARCH 13, 1989.—Ordered to be printedFiled under authority of the order of the Senate of March 9 (legislative day,
January 3), 1989

Mr. BIDEN, from the Committee on the Judiciary,
submitted the following

REPORT

[To accompany S. 270]

The Committee on the Judiciary, to which was referred the bill (S. 270) to modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property, having considered the same, reports favorably thereon and recommends that the bill do pass.

I. PURPOSE

The purpose of S. 270 is to clarify the treatment of intellectual property rights under the antitrust laws by prohibiting courts from presuming the market power necessary for liability merely from the existence of a patent or copyright.

Innovation is a cornerstone of a strong American economy. One sure way to support innovation is to protect the fruits of creativity and invention. S. 270 is directed toward this goal. It will level the playing field so that intellectual property rights are treated in litigation the same as, not worse than, other property rights.

II. LEGISLATIVE HISTORY

Congress enacted the federal intellectual property laws pursuant to its constitutional power to promote the progress of science and useful arts. *See* U.S. Const. I, Sec. 8, cl. 8. The intellectual property laws increase social welfare by encouraging investment in innovation. By recognizing intellectual innovations as property, these laws provide inventors, as well as authors and other artists, with exclusive rights to the use of their inventions and original works

for a limited time. These rights enable innovators to capture some of the economic rewards of their efforts.

The antitrust laws protect consumers and businesses by ensuring open and competitive markets. In preventing monopolists from illegally dominating or blocking access to markets, the antitrust laws also encourage innovation.

Many courts have presumed the requisite market power for antitrust liability merely from the existence of a patent or copyright. Commentators have disagreed with these court decisions, concluding that the legally enforceable property rights granted by our patent and copyright laws do not necessarily lead to monopoly control of economically relevant markets. The committee believes that the mistaken characterization of intellectual property rights as automatically granting meaningful economic power over a particular market has led to unnecessarily harsh treatment of patents and copyrights in some antitrust cases. Reform of the treatment of intellectual property under the antitrust laws is therefore necessary.

In *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985), for example, the Court of Appeals for the Ninth Circuit treated the defendant's refusal to license copyrighted computer software except to purchasers of its computer hardware as a per se unlawful tying arrangement. A tying arrangement is a form of package sale in which a seller conditions the sale or lease of one product (the tying product) upon the sale or lease of a second product (the tied product). Under certain circumstances, the antitrust laws condemn tying arrangements as per se unlawful. See *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984) (stating the elements of per se illegal tying arrangements). Sufficient economic power in the tying product market to restrain appreciably competition in the tied product market is one of the elements of a per se unlawful tying arrangement.

The district court hearing the *Data General* case reversed a jury verdict in favor of the plaintiffs. The court concluded that the defendant lacked sufficient economic power in the software market for the tying arrangement to be illegal per se.

The ninth circuit reversed and reinstated the jury verdict in favor of the plaintiffs. The court found that the software system's copyright established the software's distinctiveness as a matter of law. It held that there was sufficient evidence from which the jury reasonably could have concluded that the software was sufficiently unique and desirable to an appreciable number of buyers to enable the defendant to force those consumers to buy the hardware. Thus, the tying arrangement was illegal per se.

The ninth circuit specifically rejected the lower court's market analysis which focused on functionally equivalent substitutes for the copyrighted software. It said that the existence of substitutes for the software was not relevant to whether sufficient economic power existed for an illegal tie-in:

If a seller's product is distinctive, not available from other sources, and sufficiently attractive to some buyers to enable the seller by tying arrangements to foreclose a part of the market for a tied product, the adverse impact on competition in the tied product is not diminished by the

fact that other sellers may be selling products similar to the tying product.

734 F.2d at 1345.

To the extent that this decision requires the plaintiff to establish that the defendant possesses economic power in the tying product market, it is unobjectionable. However, the decision can also be interpreted to mean that the existence of a copyright automatically leads to a presumption of economic power. The purpose of S. 270 is to clarify that such a presumption is inappropriate.

Justice White, joined by Justice Blackmun, dissented from the Supreme Court's denial of *certiorari* in *Data General*. Although Justice White acknowledged the difficulties posed by a review of an appellate court's order reinstating a jury verdict vacated by the trial court, he stated:

[T]his case raises several substantial questions of anti-trust law and policy, including * * * what effect should be given to the existence of a copyright or other legal monopoly in determining market power.

At stake is more than the resolution of this single controversy or even the clarification of what may seem at times to be a collection of arcane legal distinctions. In the highly competitive, multi-billion dollar a year computer industry, bundling of software and hardware, or of operating systems and central processing units, is somewhat common, and any differentiated product is especially attractive to some buyers. The reach of the decision in this case is potentially enormous, and as the United States strongly urges us to do, I would grant *certiorari* to address the substantial issues of federal law presented.

473 U.S. at 909.

The previous year, in 1984, a majority of the Supreme Court had asserted in dicta:

[I]f the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power.

Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984). This statement, coupled with the Supreme Court's *certiorari* denial in the *Data General* case, has sent a signal to intellectual property owners using package distribution schemes that they may be the target of antitrust suits relying on the presumption that patents or copyrights automatically confer market power.

Commentators have sharply criticized the presumption of sufficient market or monopoly power to warrant antitrust liability solely from the existence of a patent or copyright. For example, F.M. Scherer, professor of economics, Swarthmore College, has observed:

A patented product may well be unique. It may, however, face a lot of substitutes, perhaps equally unique; and, as a result of this extensive availability of substitutes, confer very little, if any, monopoly power. Statistical stud-

ies suggest that the vast majority of all patents confer very little monopoly power—at least, they are not very profitable.

Panel Discussion, *The Value of Patents and Other Legally Protected Commercial Rights*, 53 Antitrust L.J. 535, 547 (1985).

Herbert Hovenkamp, law professor, University of Iowa, has stated:

Many patents confer absolutely no market power in their owners, and often patented products are not even marketable at their cost of production. * * * The economic case for "presuming" sufficient market power to coerce consumer acceptance of an unwanted tied product simply because the tying product is patented [or] copyrighted * * * is very weak.

H. Hovenkamp, *Economics and Federal Antitrust Law*, Sec. 8.3 at 219 (1985).

Another commentator has noted:

Patents and copyrights are sometimes quite valuable and give to their owner a degree of market power. More often than not, however, a patent or copyright provides little, if any, market power. Thus, the presumption of sufficient market power leading to a per se condemnation of a tying arrangement involving such products is unwarranted. * * * Tying arrangements involving patented or copyrighted products should be treated like other tying arrangements and should only be condemned upon a showing of actual economic power.

Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements*, 85 Colum. L. Rev. 1140, 1156 (1985).

The presumption of market power in antitrust cases involving patents or copyrights may inhibit the development and dissemination of technology. As a threshold matter, the threat of antitrust liability may act as a disincentive to the creation and distribution of new technology. However, even after a product has been developed and is enjoying public distribution, the possibility that a court will apply the presumption of market power may divert corporate resources toward litigation and away from vital research and development endeavors.

Responding to these concerns, Senators Leahy, Hatch, Biden, Thurmond, DeConcini, Humphrey, Simon, Kennedy, and Kohl introduced S. 270. S. 270 has its genesis in the 98th Congress with the administration's National Productivity and Innovation Act, S. 1841, which was introduced by Senator Thurmond. That legislation would have applied the rule of reason to antitrust challenges to joint research and development ventures and to agreements licensing intellectual property rights. It also would have reformed the patent and copyright misuse doctrines and provided greater protection for process patents. Only the joint research and development provisions of that proposal were enacted in the National Cooperative Research Act of 1984, Public Law 98-462.

99TH CONGRESS

In the 99th Congress, Senators Hatch and Leahy introduced S. 2944. This legislation would have required that antitrust claims involving agreements to convey intellectual property rights be analyzed under a rule of reason standard and would have eliminated treble damage recoveries for antitrust claims involving these agreements. One of the bill's key objectives was to eliminate the presumption of market power in antitrust cases arising merely from the existence of a patent or copyright. Representative Hamilton Fish, Jr., had previously introduced legislation comparable to S. 2944 in the House of Representatives as H.R. 4070.

100TH CONGRESS

In the 100th Congress, Senators Leahy and Hatch reintroduced the legislation (S. 438). S. 438 was cosponsored by Senators Thurmond, Humphrey, Baucus and DeConcini. Congressman Fish introduced a bill similar to S. 438. Hearings on the Fish bill, H.R. 557, were held before the Subcommittee on Monopolies and Commercial Law of the House Judiciary Committee on April 30, 1987.

On October 20, 1987, the Senate Subcommittee on Technology and the Law, and Antitrust, Monopolies and Business Rights held a joint hearing on S. 438. Testifying at the Joint hearing were: Congressman Fish; Sanford Feman, Esq., for the Hewlett-Packard Co.; Prof. Carl Shapiro of the Woodrow Wilson School, Princeton University; Rebert P. Taylor, Esq., for the American Bar Association; Jack E. Brown, Esq., of Brown & Bain, Pheonix, AZ; and Thomas M. Susman, Esq., for Digital Equipment Corp.

In his opening remarks at the joint subcommittee hearing, Senator Leahy observed that as a result of the discriminatory treatment accorded patents and copyrights in some antitrust cases,

American business may be forced to avoid agreements that would permit them to cut costs by developing efficient distribution schemes for functionally related products * * *. In some cases, the threat of antitrust liability even deters American companies from developing new technology.

Intellectual Property Antitrust Protection Act, 1987: Hearing on S. 438 before the Subcommittees on Technology and the Law and Antitrust Monopolies and Business Rights of the Senate Committee on the Judiciary, 100th Cong., 1st Sess. (1987).

In his statement when the bill was introduced, Senator Hatch stated:

Some recent judicial decisions have created uncertainty in the high-technology community by invalidating licensing practices which do not have anticompetitive consequences * * *. The proposed legislation would send a reliable signal to the courts and the business community that would encourage, rather than discourage, technological innovation.

133 cong. Rec. S 1597 (Feb. 3, 1987).

Congressman Fish testified in support of H.R. 557 and S. 438 at the joint hearing. With respect to the presumption that a patent or copyright creates market power, Congressman Fish concluded:

[T]raditional antitrust analysis of intellectual property licensing agreements has increasingly become outdated in a high-technology setting. * * * The presumption of market power, as it has been frequently applied in the courts to licenses involving intellectual property, is simply bad law and should be overtuned.

Mr. Sanford Feman of the Hewlett-Packard Company's Medical Products Group used a heart monitoring system to support his testimony concerning the harm caused by the antitrust laws' current treatment of copyrighted products. To control quality and prevent malfunctions caused by use of the heart monitor's components with other manufacturers' equipment, Hewlett-Packard sells the heart monitor's hardware and copyright software together as a system. According to Mr. Feman, however, the *Data General* decision could require Hewlett-Packard to separate the components of the monitoring system:

We are going to tell [company managers], for example, that the software and the hardware on this [heart monitor] should be treated by the courts like a mattress and a bed—you have to be able to sell one without the other. * * * We think that would be bad for competition, bad for health care providers, bad for health care recipients, and bad for manufacturers.

Referring to the heart monitor, Carl Shapiro, professor of economics and public affairs at Princeton University, also testified about harm to consumers caused by the current treatment of intellectual property licensing agreements:

There are a variety of beneficial effects of licensing that are in the interest of consumers, and some of these desirable licensing arrangements, such as that described here, are being prohibited under the current treatment of the law.

Mr. Robert Taylor, representing the American Bar Association, agreed that the presumption of market power penalized intellectual property owners:

The problem that you have in the area where the tying product is a patented process or a patented article or is a copyright is the courts say that they simply are going to foreclose the plaintiff from any need to prove market power. So you end up with a circumstance where the ability of a licensor to commercialize his product is simply not there.

Mr. Thomas M. Susman, representing Digital Equipment Corp., also criticized the presumption of market power in antitrust cases. Mr. Susman commented:

Mere ownership of a patent or copyright does not convey market power. There may be no demand for the patented

of copyrighted product. Or, there may be substitutable products on the market; the ability of the owner of the patented or copyrighted product to raise prices above a competitive level is limited by the existence of these substitutes. Yet, even in these circumstances, current law provides that market power sufficient to find an antitrust violation will be presumed. This should be changed by Congress.

The committee is aware that many in the high-technology industry, particularly companies that market innovative products like computer systems, continue to believe that legislation is needed which not only addresses the market power presumption, but also applies an approach different from traditional tying analysis to arrangements involving technologically integrated products. Manufacturers often integrate and sell technologically related products together to be used as a system. The integration of these technologically related products, it is argued, is designed to provide a complete solution to a customer's problem, or to assure efficient operation. Some courts have applied traditional antitrust tying analysis to these products. Such analysis can lead, these companies argue, to a requirement that certain copyrighted software, and other integrated portions of a computer system in which the software performs, must be sold separately from that system. *See Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985). *But see A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673 (6th Cir. 1986); *Will v. Comprehensive Accounting Corp.*, 776 F.2d 665 (7th Cir. 1985), *cert. denied*, 106 S. Ct. 1659 (1986).

On July 28, 1988, S. 438 was reported favorably by poll from both the Subcommittee on Technology and the Law and the Subcommittee on Antitrust, Monopolies and Business Rights. On August 3, 1988, the Judiciary Committee considered an amendment in the nature of a substitute, which added Title II on Patent Misuse to the bill. The substitute amendment, cosponsored by Senators Leahy, Hatch, Thurmond, DeConcini, Kennedy, Humphrey and Metzenbaum, unanimously was ordered favorably reported. Both titles of S. 438 were designed to eliminate unfair penalties placed by courts on intellectual property owners based on outdated and erroneous judicial doctrines.

The Senate passed S. 438 three times. On October 4, 1988, the Senate passed S. 438 unanimously by voice vote (*see Congressional Record*, p. S 14434). On October 19, 1988, the Senate passed S. 438 as an amendment to H.R. 4972, the Patent and Trademark Office Authorization Act (*see Congressional Record*, p. S 15947). And on October 19, 1988, the Senate passed S. 438 as an amendment to H.R. 5347, the Municipal Bankruptcy Act (*see Congressional Record*, p. S 16319).

The House passed a modified version of Title II on Patent Misuse as part of the Patent and Trademark Office Authorization Act. This measure was signed into law on November 19, 1988 (P.L. 100-703).

101ST CONGRESS

Senator Leahy introduced S. 270, the Intellectual Property Antitrust Protection Act of 1989, on January 25, 1989 (see Congressional Record, p. S 722). Senators Hatch, Biden, Thurmond, DeConcini, Humphrey, Simon, Kennedy, and Kohl cosponsored the bill, which is identical to Title I of S. 438 as reported by the Judiciary Committee in the 100th Congress. S. 270 was referred to the Judiciary Committee and held at the full Committee. At its first executive meeting on February 23, 1989, the Judiciary Committee favorably reported S. 270 to the full Senate. 7

III. DISCUSSION

S. 270 addresses the application in antitrust cases of a presumption of market power arising from a patent or copyright. This presumption punishes innovators engaged in procompetitive marketing, distribution or licensing practices.

ELIMINATION OF PRESUMPTION OF MARKET POWER

1. Development and status of the presumption

The Supreme Court formulated the presumption of market power in antitrust cases involving patented and copyrighted products. The presumption evolved from the Supreme Court's patent misuse doctrine, which bars a patent owner from asserting a patent infringement claim if the owner has tried to extend his patent grant beyond its statutory limits. Early examples of misuse were tying arrangements. See *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942); *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*, 243 U.S. 502 (1917).

The Supreme Court first applied the policy underlying the patent misuse doctrine to an antitrust context in *International Salt Co. v. United States*, 332 U.S. 392 (1947). There, the defendant leased patented salt processing machines to various processors on the condition that the processors also purchase their salt from the defendant. The Court found that the defendant had unlawfully extended its patent rights in the salt processing machines to restrain competition in salt. In support of its holding, the Court noted that the "patents confer a limited monopoly of the invention they reward. * * * But the patents confer no right to restrain use of, or trade in, unpatented salt." *Id.* at 395-96. One year later, in *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948), the Supreme Court extended *International Salt's* patent misuse rationale to copyrighted products. It viewed the distribution of copyrighted motion pictures on the condition that exhibitors accept uncopyrighted or less desirable films, a practice known as "block-booking," as an unlawful attempt by the copyright holder to extend its copyright monopoly to uncopyrighted products. The Court held that tying the licensing of certain copyrighted feature films to other films was per se illegal.

The Supreme Court first expressly articulated the market power presumption when it revisited the practice of "block-booking" motion pictures in *United States v. Loew's Inc.*, 371 U.S. 38 (1962). In the intervening 14 years since the *Paramount Pictures* decision,

the Court expressly began requiring that the defendant have sufficient economic power in the market for the tying product before condemning a tying arrangement as illegal per se. See e.g., *Northern Pacific Railway v. United States*, 356 U.S. 1 (1958). The Court in *Loew's* could no longer rely exclusively on the policy of the misuse doctrine as the rationale for condemning the block-booking arrangement. Instead, the Court focused on the importance of the seller's economic power in the tying product market and held that such power "is presumed when the tying product is patented or copyrighted." 371 U.S. at 45. Observing that a product's uniqueness may confer the kind of economic leverage which will enable a seller to enforce an unlawful tying arrangement, the Court reasoned that "[s]ince one of the objectives of the patent laws is to reward uniqueness, * * * the existence of a valid patent on the tying product, without more, establishes a distinctiveness sufficient to conclude that any tying arrangement involving the patented product would have anticompetitive consequences." *Id.* at 46 (emphasis added). Asserting that *Paramount Pictures* had extended this reasoning to copyrighted films, the Court found the block-booking contracts in *Loew's* to be per se unlawful.

The Supreme Court has reiterated the presumption of market power in dicta in its tying arrangement cases, most recently in *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 16 (1984). However, in a concurring opinion, Justice O'Connor, joined by three other Justices, challenged the rationale underlying the presumption, stating:

A common misconception has been that a patent or copyright, a high market share, or a unique product that competitors are not able to offer suffice to demonstrate market power. While each of these three factors might help to give market power * * * a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.

Id. at 37, n. 7 (O'Connor, J., concurring).

Lower courts have split in three directions on whether the requisite market power to support antitrust liability is actually conferred by the existence of a patent or copyright. While some courts have accepted the presumption as conclusive evidence of sufficient market power to support a finding of antitrust liability, other courts have suggested that the presumption raises a rebuttable inference of the patent or copyright holder's market power. Recently, a few courts have stated that a patent or copyright does not necessarily confer market power and have declined to rely on the presumption in determining whether a tying arrangement involving a patent or copyright constitutes a per se violation of the antitrust laws.

Those courts adhering to the *Loew's* decision have accepted the proposition that the existence of a patent or copyright conclusively establishes the requisite economic power to enable a patent or copyright holder to unlawfully coerce a consumer into accepting other products. See, e.g., *Hazeltine Research v. Zenith Radio Corp.*, 239 F. Supp. 51 (N.D. Ill. 1965), *aff'd* 388 F.2d 25 (7th Cir. 1967), *aff'd in part and rev'd in part*, 395 U.S. 100 (1969); *Duplan Corp. v.*

Deering Milliken, Inc., 444 F. Supp. 648 (D.S.C. 1977), *aff'd in part and rev'd in part*, 594 F.2d 979 (4th Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980).

Without addressing the appropriateness of the presumption, other courts have suggested that the presumption is rebuttable and that it shifts the burden of persuasion to the defendant to establish that the "presumed" market power does not exist. See *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985). However, the ninth circuit's approach, which does not permit consideration of evidence relating to the availability of substitutes, may suggest that a patent or copyright holder will never be able to rebut the presumption. S. 270 precludes this approach.

A few jurisdictions have recently rejected the presumption in favor of an analysis of the patent or copyright holder's actual market power with respect to the patented or copyrighted product. In *A.I. Root Co. v. Computer/Dynamics, Inc.*, 806 F.2d 673 (6th Cir. 1986), the Court of Appeals for the Sixth Circuit considered the legality of an arrangement whereby a manufacturer of small business computers and copyrighted software conditioned the software's sale on its use with the manufacturer's computers and the licensing of other software. The manufacturer controlled only 2-4 percent of the small computer market. In rejecting the *Loew's* presumption and finding that the licensing practice did not constitute per se liability under the antitrust laws, the sixth circuit characterized the pronouncement in *Loew's* as "overbroad and inapposite to the instant case." *Id.* at 676. In support of its holding, the sixth circuit observed that "[m]ore often than not * * * a patent or copyright provides little, if any, market power." *Id.* (quoting Note, *The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements*, 85 Colum. L. Rev. 1140, 1156 (1985)).

In *Nobel Scientific Industries v. Beckman Instruments*, 670 F. Supp. 1313 (D. Md. 1986), *aff'd*, 831 F.2d 537 (4th Cir. 1987), the district court similarly rejected the proposition that the existence of a patent automatically establishes sufficient market power for antitrust liability. There, the court considered the legality of a tying arrangement involving machinery which incorporated various patented parts. After evaluating actual market conditions which revealed the availability of substitutes for the machinery as well as its patented parts, the court determined that the arrangement was not a per se unlawful tie-in. *Id.* at 1328-29.

2. Need for elimination of the presumption

Although patents and copyrights constitute legally enforceable property rights, they do not in and of themselves necessarily constitute economic monopolies. Similarly, although the "uniqueness" or "distinctiveness" of a particular product may be essential to the award of a patent or copyright, the patent or copyright does not necessarily result in economic power when evaluated under standard antitrust principles.

The application of the presumption of market power forecloses a court's consideration of factors that the court would consider relevant in antitrust cases involving a nonpatented or noncopyrighted product. For example, it prevents courts from considering whether

there are substitute products for a patented product used in a tying arrangement. Thus, in some cases the presumption has penalized intellectual property owners. The presumption also may increase the likelihood that antitrust claims will be brought against patent and copyright owners who should not be subject to antitrust liability. In short, the undesirable economic result may be the hindrance of the development and dissemination of innovative technology.

By eliminating the presumption of market power in antitrust cases involving patents, copyrights and mask works (semiconductor chip designs), the committee does not sanction anticompetitive arrangements for the distribution of, or refusal to distribute, intellectual property rights and innovative products.

S. 270 eliminates the presumption of market power. The existence of an intellectual property right, along with other evidence concerning the distribution of such a right or product protected by such a right, will still be relevant to the determination of market definition, market power or monopoly power. The elimination of the presumption will simply require plaintiffs to assume their proper burden of proof in antitrust cases involving intellectual property. It will require only that courts evaluate practices involving intellectual property rights under the same antitrust principles that are applied to practices involving other forms of property.

In the case of a tying arrangement where the elements of a per se unlawful tie have been factually proven, the intellectual property owner will remain subject to per se liability to the same extent as owners of other forms of property. The elements of a per se unlawful tying arrangement include actual proof of market power.

The committee determined that it was not necessary to include trademarks in the bill's definition of intellectual property rights. The owner of a trademark has the exclusive right to use the mark in connection with its products. Because they protect only a producer's business name, the rights associated with a trademark are typically narrower than those that attach a patent, copyright or mask work.

The committee also determined that it was not necessary for the bill to cover trade secrets, which are governed primarily by State, not federal, law. A trade secret protects a proprietor against wrongful appropriation of commercially advantageous information only as long as he or she keeps it secret. Competitors are free to develop their own trade secrets. The committee is not aware of any court that has concluded that a trade secret raises a presumption of market power. *Cf. In re Data General Corp. Antitrust Litigation*, 490 F. Supp. 1089, 1113-14 (N.D. Cal. 1980), *aff'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 473 U.S. 908 (1985) ("it has never been held that trade secret protection is sufficient to create presumption of economic power").

The committee does not intend to change current law relating to whether a trade secret or a trademark, standing alone, creates a presumption of market power.

IV. VOTE OF COMMITTEE

The Committee on the Judiciary, on February 23, 1989, with a quorum present, considered the bill. By a voice vote, the committee ordered S. 270 favorably reported without amendment.

V. TEXT OF S. 270

[S. 270, 101st Cong., 1st Sess.]

A BILL To modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Intellectual Property Antitrust Protection Act of 1989".

PROHIBITION OF MARKET POWER PRESUMPTION

SEC. 2. In any action in which the conduct of an owner, licensor, licensee, or other holder of an intellectual property right is alleged to be in violation of the antitrust laws in connection with the marketing or distribution of a product or service protected by such a right, such right shall not be presumed to define a market or to establish market power, including economic power and product uniqueness or distinctiveness, or monopoly power.

SEC. 3. For purposes of this Act—

(1) the term "antitrust laws" has the meaning give it in subsection (a) of the first section of the Clayton Act (15 U.S.C. 12(a)); and

(2) the term "intellectual property right" means a right, title, or interest—

(A) in subject matter patented under title 35 of the United States Code, or

(B) in a work, including a mask work, protected under title 17 of the United States Code.

VI. SECTION-BY-SECTION ANALYSIS

Section 1

This title, when enacted, may be cited as the "Intellectual Property Antitrust Protection Act of 1989."

Section 2

This section provides that an intellectual property right shall not be presumed to define a market, or establish market power or monopoly power, in any action in which the owner, licensor, licensee or other holder of an intellectual property right is alleged to be in violation of the antitrust laws in connection with the marketing or distribution of a product or service protected by such a right.

The term "intellectual property right" is defined in Section 3 to cover patents, copyrights and mask works.

The references to "owner," "licensor," "licensee" and "holder" of an intellectual property right recognizes the different formulations given to a person or entity with a right, title or interest in intellectual property. For example, courts usually refer to someone with

an interest in a patent as either an owner, licensor or licensee. Copyright law uses the term "holder" of rights. The listing of the different terms is intended to ensure that the bill will cover both sides of transactions involving intellectual property.

The reference to antitrust actions challenging conduct "in connection with the marketing or distribution of a product or service protected by such a right" is intended to apply to any antitrust action challenging the legality of the defendant's conduct involving the marketing or distribution of an intellectual property right. In the case of a patent, for example, this would include the sale of patented products, the licensing of, or refusal to license, patent rights, and the enforcement of patent rights through legal action.

In describing the power that a defendant must have in the marketplace to be liable under the antitrust laws, courts have used, sometimes interchangeably, the following terms: market power, monopoly power, economic power and product uniqueness or distinctiveness. See, e.g., *Jefferson Parish Hospital Dist. No. 2 v. Hyde*, 466 U.S. 2, 13-14 (1984) (market power); *U.S. v. Loew's, Inc.*, 371 U.S. 38, 45-49 (1962) (economic power and product uniqueness or distinctiveness); *International Distribution Centers, Inc. v. Walsh Trucking Co.*, 812 F.2d 786, 791 n.3 (2d Cir. 1987) (Market power is a "synonym" for monopoly power), *Consolidated Gas Co. of Florida v. City Gas Co. of Florida*, 665 F. Supp. 1493 (S.D. Fla. 1987) (economic power, monopoly power and market power). The inclusion of all of these terms in the bill is intended to ensure that the bill's remedial goal will not be frustrated by the use of a description other than "market power" for the type of power that gives rise to antitrust liability.

Section 3

Subsection (1) incorporates by reference the definition of the term "antitrust laws" used in subsection (a) of the first section of the Clayton Act, 15 U.S.C. Sec. 12(a).

Subsection (2) defines the term "intellectual property right" to mean a right, title or interest in a patent, copyright or mask work. Although the patent and copyright laws use the term "right" to refer to a person's property interest in these forms of intellectual property, courts also use the terms "title" or "interest." For example, a licensee's bundle of rights in a patent is often referred to as an "interest." By including the terms "right," "title" or "interest," the committee intends to cover all possible property interests in the intellectual property rights listed in the bill.

Title 35 and title 17 of the United States Code govern the subject matters protected by a patent or copyright, respectively. Chapter 9 of title 17, added in 1984, protects semiconductor chip designs, known as mask works. Although the committee was not aware of any cases in which a court had presumed market power from the existence of a mask work protected under title 17, there has been little time for judicial development under this new law. The committee was concerned that, with more time, courts might extend the presumption to mask works as they had already done to copyrights. This could cripple important sectors of our high-technology industry.

VII. COST ESTIMATE

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and Section 403 of the Congressional Budget Act of 1974, the committee provides the following cost estimate, prepared by the Congressional Budget Office:

U.S. CONGRESS,
CONGRESSIONAL BUDGET OFFICE,
Washington, DC, March 2, 1989.

Hon. JOSEPH R. BIDEN, Jr.,
Chairman, Committee on the Judiciary,
U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has reviewed S. 270, the Intellectual Property Antitrust Protection Act of 1989, as ordered reported by the Senate Committee on the Judiciary, February 23, 1989. We expect that enactment of the bill would result in no cost to the federal government or to state or local governments.

S. 270 would modify the application of antitrust laws in order to encourage the licensing of intellectual property. Specifically, the bill would prohibit courts from presuming the market power necessary for antitrust liability from the existence of an intellectual property right.

If you wish further details on the estimate, we will be pleased to provide them. The CBO staff contact is Douglas Criscitello, who can be reached at 226-2860.

Sincerely,

JAMES L. BLUM,
Acting Director.

VIII. REGULATORY IMPACT STATEMENT

Pursuant to paragraph 11(b), Rule XXVI of the Standing Rules of the Senate, the committee, after due consideration, concludes that the bill will not have direct regulatory impact.

IX. CHANGES IN EXISTING LAW

There are no changes in existing law.

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